BRIEF IN SUPPORT OF FOREGOING PETITION FOR WRIT OF CERTIORARI.

Opinions of the Court Below.

The opinion of the Circuit Court of Appeals is reported at 130 F. (2d) 942, and is set forth in the Record at pages 203-208.

The findings of fact and opinion of the Board of Tax Appeals is reported at 42 B.T.A. 1052, and is set forth in the Record at pages 193a-199a.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on September 1, 1942 (R. 209).

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229 (43 Stat. 938; 28 U. S. C. A. Sec. 347).

Statement of Facts—Questions Involved.

The petition for the writ of certiorari contains a statement of the case and the questions involved, and also, a statement of all the facts material to their consideration.

Specifications of Errors.

1. In determining the Federal gift tax on petitioner's gift of corporate stock, which involved a determination of the taxable value of the stock, the Circuit Court erred in failing to give proper effect, if any, to the fact that the stock was subject to a restrictive agreement giving the corporation the right to repurchase the stock at varying per centages of its book value as aforesaid.

2. The Circuit Court erred in that it ignored the uncontradicted and unimpeached testimony of the petitioner's expert witnesses as to the value of said stock.

3. The Circuit Court erred in that its determination of the value of said stock is arbitrary and capricious, not being supported by substantial evidence.

4. The Circuit Court erred in entering judgment affirming the decision of the Board of Tax Appeals.

Argument.

1. The decision of the Circuit Court in the instant case is probably in conflict with the decision of this Court in *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481, or with the decision of this Court in *Helvering* v. *Salvage*, 297 U. S. 109.

As has been noted, the subject of the gift involved in this proceeding was a voting trust certificate evidencing the petitioner's equitable or beneficial ownership of 4,500 shares of the common stock of E. J. Lavino and Company, *subject to the terms and provisions of the restrictive agreement.* It has also been noted that the restrictive agreement provided that the petitioner could not sell his stock so long as he remained in the employment of the Company. The agreement further provided that during the period of one year after the termination of the petitioner's employment, the Company had an option to purchase his stock at (a), 33⅓ per cent, (b), 50 per cent, or (c), 75 per cent, of its book value as shown on the Company's statement as of the date of the last closing of its books prior to such termination, the applicable percentage depending upon whether the termination of the petitioner's employment was due, (a), to his discharge by the Company, for cause, (b), his resignation *without* the approval of the Company's board

of directors, or, (c), his death, or resignation *with* the approval of the board of directors.

Considering these provisions of the restrictive agreement, how could an employee-owner of the stock and a prospective purchaser, assuming both to have been "reasonable men", have arrived at the "fair market value" of the stock on December 24, 1937? Since the date of the termination of the employment of the employee-owner of the stock could not have been ascertained, it would obviously have been impossible to determine the book value of the stock as of the date of the last closing of the books of the Company prior to such termination. Moreover, it would have been impossible to foresee the cause, or reason, for the termination of the employment of the employee, i. e. whether such termination would be caused by the employee's discharge, his resignation, with or without the approval of the Company's board of directors, or by his death. Thus, neither the base, nor the percentage to be applied thereto, in determining the amount which the Company would have to pay, if, at some indefinite time in the future, it elected to exercise its option to purchase the employee's stock after the termination of his employment, were known, nor could they have been ascertained, on December 24, 1937.

In other words, on December 24, 1937, neither the employee-owner of common stock of E. J. Lavino and Company, subject to the restrictive agreement, nor a prospective purchaser of the stock, would have known when, if ever, the purchaser (if he purchased the stock), would become the absolute owner thereof. They would not have known when, if ever, the Company would elect to purchase the stock, nor the price it would have to pay if it did elect to purchase the stock. They would have known, however, that if the Company did elect to purchase the stock, at some indefinite time in the future, the price it would have to pay

might be as low as one-third, or as high as three-fourths, of its book value as of the date of the last closing of its books prior to the termination of the employee's employment, and also, they would have known that there was, of course, a possibility that the Company might encounter financial difficulties, or suffer reverses, as the result of which its stock might become absolutely worthless.

The manifest uncertainties inherent in this situation could be developed indefinitely. For example, under ordinary circumstances, an investor in the common stock of a corporation is faced with the uncertainty as to the future earnings of the corporation, and what part of such earnings will be declared as dividends; but he at least knows that he will receive 100 per cent of any appreciation in the value of his stock. In the situation now under consideration, a prospective purchaser of the common stock of E. J. Lavino and Company would have been faced with the usual uncertainties, but in addition, he would have known that he would probably only share in any increase in the value of his stock *to the extent that such increase was reflected in the books of the Company, and he would not have known whether he could ultimately receive 33⅓, 50, or 75 per cent of any increase in value so reflected.*

Accordingly, since the evaluation of the stock here involved as of December 24, 1937, involved so many unknown and unascertainable factors, it is respectfully submitted that either (a) the said stock had no fair market value capable of being ascertained with reasonable certainty; or, (b), the fair market value of the said stock was not in excess of the minimum amount at which E. J. Lavino and Company might have become entitled to repurchase the stock. In other words, it is submitted that the instant case is governed either by the decision of this Court in *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481, or by the decision of this Court in *Helvering* v. *Salvage*, 297 U. S. 109.

Helvering v. *Tex-Penn Oil Co., supra,* involved the evaluation of the stock of a new corporation which had been organized to acquire and develop certain oil properties. A part of its stock had been distributed pursuant to an agreement which prevented the recipients from selling the stock for a period of ninety days, and a bankers' syndicate, which had agreed to purchase another block of the stock, had the right to extend the said period for an additional ninety days. In holding that the stock had no fair market value when distributed to the recipients, this Court said (300 U. S. 481 at 499):

> "The court is also of opinion that the judgments must be affirmed upon the ground that in the peculiar circumstances of this case, the shares of Transcontinental stock, regard being had to their highly speculative quality and to the terms of a restrictive agreement making a sale thereof impossible, did not have a fair market value, capable of being ascertained with reasonable certainty, when they were acquired by the taxpayers.
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> "In the absence of such value, the ownership of the shares did not lay the basis for the computation of a gain at the time they were received, or for a tax as of that date under the applicable statute."

Even though the stock here involved may not have had a "highly speculative quality", it is submitted that here, the restrictive agreement itself deprived the stock of "fair market value, capable of being ascertained with reasonable certainty".

In any event, it is submitted that the stock here involved could not have had a fair market value in excess of the minimum amount at which E. J. Lavino and Company might have become entitled to repurchase the stock. In *Helvering* v. *Salvage,* 297 U. S. 106, *supra,* it appeared that in December, 1922, the taxpayer acquired 1,500 shares of the stock of the Viscose Company for which he paid the said Com-

pany $100 per share, and he also entered into an agreement, with the said Company, that he would not engage in business competition with the Company. The taxpayer further agreed that during 1923, the Company could repurchase five-sevenths of the stock at par, during 1924, four-sevenths, etc. Intrinsically, when unencumbered, the stock was worth $1,164.70. Subsequently, the question arose as to what was the taxpayer's cost basis for the said shares of stock, in determining his gain on a disposition of the stock, or a part thereof, in 1929, and in holding that the cost basis of five-sevenths of the shares was their par value, or $100 per share, the Circuit Court of Appeals, for the Second Circuit, said (76 Fed. (2d) 114):

> "As to two-sevenths of the 1,500 shares, the petitioner acquired their full value on December 30, 1922. As to the rest, the Viscose Company still had a string upon them by virtue of its option. Until the option expired in subsequent years, the market value of the shares subject to it could scarcely exceed the price at which the company could repurchase them, namely, par. See Wilson v. Bowers, 57 F. (2d) 682, 683 (C. C. A. 2) * * * Two-sevenths of the shares (428 4/7) were not subject to the option and had a market value of $1,164.70 a share, a total of $499,157.14; five-sevenths (1,071 3/7) had a market value of $100 per share, or $107,142.86. This gives a total market value for the 1,500 shares of $606,300."

In affirming this decision, this Court said (297 U. S. 109):

> "Considering the option to repurchase at par, outstanding in 1922, there could be no proper finding of fair market value at that time in excess of $100 per share. In the circumstances, the court did not err in so holding."

In the instant case, if the petitioner had been discharged from his employment by E. J. Lavino and Company on or before December 31, 1937, the Company would have had the

right, at any time within one year from the date of such discharge, to purchase the petitioner's stock at 33⅓ per cent. of its book value as of December 31, 1936, or, in other words, at 33⅓ per cent. of $36.03, or $12.01 per share. In these circumstances, it is submitted that the decision of this Court in *Helvering* v. *Salvage, supra,* is ample authority for the proposition that the fair market value of the stock here involved at December 24, 1937, was not in excess of the said sum of $12.01 per share.

As has been noted, the Circuit Court in the instant case determined that on December 24, 1937, the stock here involved had a fair market value of $43 per share. Hence, it is obvious that the said Court actually gave no force or effect whatsoever to the restrictive or option agreement, and it is therefore submitted that its decision is in conflict either with the decision of this Court in *Helvering* v. *Tex-Penn Co., supra,* or with the decision of this Court in *Helvering* v. *Salvage, supra.*

2. The decision of the Circuit Court in the instant case is in conflict with decisions of other Circuit Courts and the Board of Tax Appeals, (a), following *Helvering* v. *Tex-Penn Oil Co.,* 300 U. S. 481, or, (b), with such decisions following *Helvering* v. *Salvage,* 297 U. S. 109.

The decision of this Court in *Helvering* v. *Tex-Penn Oil Co.,* 300 U. S. 481, was followed by the Circuit Court of Appeals for the Second Circuit in *Propper et al.* v. *Commissioner,* 89 F. (2d) 617, and by the Board of Tax Appeals in *Kopple* v. *Commissioner,* 35 B. T. A. 1056, in both of which decisions it was *held* that the stock of the corporations there involved had no fair market value, *inter alia,* because in each case, the stock was subject to an agreement which restricted the sale thereof. Hence, if the decision in the instant case is governed by the decision of this court in *Helvering* v. *Tex-Penn Oil Co., supra,* then, it is submitted, the decision in the instant case is in conflict with the aforesaid

decisions in *Propper et al.* v. *Commissioner* and *Kopple* v. *Commissioner,* both *supra.*

On the other hand, if the decision in the instant case is governed by the decision of this Court in *Helvering* v. *Salvage,* 297 U. S. 106, then, it is submitted, the decision in the instant case is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Lomb* v. *Sugden,* 82 F. (2d) 166, and with the decision of the Board of Tax Appeals in *Bensel* v. *Commissioner,* 36 B. T. A. 246 (affirmed, 3 Cir., 100 F. (2d) 639), in both of which cases it was *held,* following *Helvering* v. *Salvage, supra,* that the value of shares of stock of a corporation, subject to an option agreement, was not in excess of the price fixed in the agreement.

3. The decision of the Circuit Court in the instant case is in conflict, *inter alia,* (a), with the decisions of the Circuit Courts of Appeals for the Second, Eighth and Ninth Circuits in *Bonwit Teller & Co.* v. *Commissioner,* 2 Cir., 53 F. (2d) 381, *Planter's Operating Co.* v. *Commissioner,* 8 Cir., 55 F. (2d) 583, and *Belridge Oil Co.* v. *Commissioner,* 9 Cir., 85 F. (2d) 762, and (b), with its own decisions in *Tex-Penn Oil Co.* v. *Commissioner,* 3 Cir., 83 F. (2d) 518 (affirmed, 300 U. S. 481), *Boggs & Buhl, Inc.* v. *Commissioner,* 3 Cir., 34 F. (2d) 859, *Pittsburgh Hotel Co.* v. *Commissioner,* 3 Cir., 43 F. (2d) 345, and *Nichols* v. *Commissioner,* 3 Cir., 44 F. (2d) 157.

As has been noted, at the hearing before the Board in the instant case, one of the petitioner's expert witnesses testified that the stock here involved, if *not* subject to the restrictive agreement, had a fair market value of $30.90 per share (R. 167a). The petitioner's second expert witness testified that the stock, if *not* subject to the restrictive agreement, had a fair market value within "* * * a low limit of somewheres around 25 and a high limit of somewheres between 35 and 40; but, roughly, I would say that

$30 a share was a fair price, all things considered" (R. 177a). This second witness further testified, in effect, that when subject to the restrictive agreement, the stock had no fair market value whatever (R. 179a, 180a), but that in any event, when so subject, the fair market value of the stock was not in excess of the minimum price at which the Company might repurchase the stock (R. 178a).

Since the Board and Circuit Court determined that the value of the said stock, when subject to the restrictive agreement, was $43 per share, it is evident that both the Board and the Court completely ignored and disregarded the testimony of the petitioner's expert witness, although the said testimony was uncontradicted and unimpeached. It is submitted that this constituted reversible error, and that as a result, the decision of the Circuit Court is in conflict with the following decisions of the Circuit Courts of Appeal for the Second, Eighth and Ninth Circuits:

Bonwit Teller & Co. v. *Commissioner,* 2 Cir., 53 F. (2d) 381;

Planter's Operating Co. v. *Commissioner,* 8 Cir., 55 F. (2d) 583;

Belridge Oil Co. v. *Commissioner,* 9 Cir., 85 F. (2d) 762.

Each of the foregoing decisions is authority for the proposition that it is reversible error for the Board to disregard competent, relevant testimony when it is not contradicted; and, as a matter of fact, the decisions of the Circuit Court of Appeals for the Third Circuit are to the same effect. See *Boggs & Buhl, Inc.* v. *Commissioner of Internal Revenue,* 3 Cir., 34 F. (2d) 859; *Pittsburgh Hotels Co.* v. *Commissioner of Internal Revenue,* 3 Cir., 43 F. (2d) 345; and *Nichols* v. *Commissioner of Internal Revenue,* 3 Cir., 44 F. (2d) 157.

It is submitted that the foregoing decisions are especially applicable in the instant case. It is true that in the instant

case, there was some evidence, principally the earnings and dividend record of the Company, upon which the Circuit Court could base its independent determination of the value of the stock here involved, *if not subject to the restrictive agreement.* However, there is nothing in the present Record to indicate that either the Board or the Circuit Court of Appeals possessed any special competency which would justify either the Board or the Court in substituting their judgment as to the effect of the restrictive agreement upon the fair market value of the stock here involved, for the judgment of the petitioner's expert witness.

4. The law with respect to the valuation of corporate stock, subject to restrictive or option agreements, for tax purposes, is in a state of confusion, which will probably result in considerable litigation unless and until the law is clarified by this Court.

It is submitted that this statement cannot be denied. In *Helvering* v. *Tex-Penn Oil Co.* 300 U. S. 481, in *Helvering* v. *Salvage,* 297 U. S. 106, and in the other decisions of the Board of Tax Appeals, and of the Circuit Courts of Appeals to which reference has been made, in determining the value of corporate stock subject to restrictive or option agreements, due effect has been given to such agreements either as depriving the stock of fair market value, or as limiting such value to the amounts fixed in the agreements.

On the other hand, in the instant case, it would seem to be clear that in determining the value of the stock here involved to be $43 per share, the Circuit Court has given no force or effect whatsoever to the restrictive agreement to which this stock was subject. As has been noted, a prospective purchaser of the petitioner's stock on December 24, 1937, would have known that if the petitioner was discharged from his employment for cause on or before December 31, 1937, the Company would have the right, at any time within one year thereafter, to purchase the stock at

$12.01 per share. It may be, as the Circuit Court said, that this result was not likely to happen, but even so, it was a possibility which a prospective purchaser of the stock would have taken into consideration, and which, it is earnestly urged, would have influenced such a purchaser to refuse to pay more than the said sum of $12.01 per share for the stock, as the petitioner's expert witness testified.

It is submitted, therefore, that in determining the value of the stock here involved to be $43 per share, the Ciircuit Court has abandoned the test of "fair market value", as prescribed in the applicable Regulations, (see Appendix hereto, page 22), and has, in effect, adopted some new test which is not explained. It is further submitted that this uncertainty and confusion in the law with respect to situations of this kind, will probably result in considerable litigation unless and until the law is clarified by this Court. As some evidence of the probable truth of this assertion, since the decision of the Circuit Court in the instant case was handed down, counsel for the petitioner has been advised, on September 17, 1942, by James Henry Hayes, Esq., 30 Rockefeller Plaza, New York, N. Y., that he had a case similar to the instant case which would soon come to trial, forum not stated. Counsel for the petitioner was also advised, on November 16, 1942, by James A. Croty, Esq., 332 Main Street, Worcester, Massachusetts, that he had an appeal then pending in the Circuit Court of Appeals for the First Circuit involving the evaluation, for the purpose of the estate tax, of "stock subject to restrictions providing that a stockholder desiring to sell was required to offer the stock first to the corporation which might buy it at book value". That case was tried in the Board of Tax Appeals before the Honorable John M. Sternhagen, the same Member of the Board before whom the instant case was tried.

It is therefore respectfully submitted that the foregoing petition for certiorari should be allowed, to the end that this

Court may clarify the law with respect to the effect to be given to restrictive or option agreements in determining the value of stock subject thereto for tax purposes, thereby putting an end to further litigation involving this problem.

5. The decision of the Circuit Court in the instant case is arbitrary and capricious, in that it is not supported by substantial evidence.

As has been noted, in the instant case, the Circuit Court, in determining the value of the stock here involved, failed to give proper effect, if any, to the fact that the stock was subject to the provisions of a restrictive agreement, which unquestionably had some effect upon the value of the stock. The Circuit Court also completely ignored and disregarded the uncontradicted and unimpeached testimony of the petitioner's expert witnesses as to the value of the stock, when subject, or when not subject to the restrictive agreement. These considerations alone would seem to indicate that the Circuit Court's determination of the value of the stock here involved, was arbitrary and capricious.

However, it is submitted that the opinion of the Circuit Court shows on its face that the Court's determination of the value of the stock here involved was arbitrary and capricious, for the following reason: Although in its opinion, the Court determines the value of the stock to be $43. per share, there is absolutely nothing in the opinion which indicates that that value is proper, rather than $20., $30., $50., or $60. per share. That Court itself characterized such an opinion as arbitrary and capricious. See *Tex-Penn Oil Co.* v. *Commissioner,* 3 Cir., 83 Fed (2d) 518, at 523, where the Court said:

> "The board might have said that the fair market value was $1, $10 or $40 a share and its reasoning would have been equally applicable. The board may not fix an arbitrary and excessive value."

Conclusion.

For the reasons herein set forth, it is respectfully submitted the prayer of the foregoing petition should be granted, and that a writ of certiorari should issue to review the judgment of the Circuit Court of Appeals for the Third Circuit entered in the cause between the above-named parties on September 1, 1942.

J. Warren Brock,
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